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ABSTRACT

This chapter of "Principles of School Business Management" provides a generic overview of the major tasks associated with financing a school district's large capital programs. The chapter opens with a brief historical review of the limited provisions made for capital outlay prior to the 1960s and of the trends in financing in recent decades. The chapter then examines specific methods used for financing capital projects, including municipal bonds, sinking funds, the use of current revenues, and the formation of holding corporations. Factors affecting the issuance of bonds are considered next, including bond ratings and the need for legal and financial advice. The chapter next outlines the prospectus' statements concerning the purpose of the issue; bond dates, types, denominations, and maturities; the paying agent; interest payment dates and rates; delivery deadlines; legal opinion; the bidding and award process; district financial information; future financing; pending litigation; and general district facts. The chapter concludes with discussion of the actual sale of issue, the registration of bonds, the investment of proceeds from the sale, advanced refunding, and bond insurance. Information that must be provided for the issuance of ratings is listed and 21 footnotes citing relevant sources are provided. (PGD)

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21
Capital Outlay and Bonding

R. Craig Wood

The financing of educational facilities is an extremely broad and varied topic within the area of financing public education.[1] Nearly every state finances the construction of public school facilities from local sources of revenue. While the main source of revenue is the property tax, each state has its unique requirements concerning debt limits on borrowing, requirements for approval of bond issues and numerous other specifications. This chapter is intended to serve as a generic overview for school business administration students on the major tasks associated with financing large capital programs. There are numerous loan and grant programs, state purchases of local school district bonds and combinations of these programs that will not be addressed by this chapter. The chapter presents numerous examples to acquaint the student of school business management with the tasks involved. It is vitally important that the examples not be used as legal or financial advice. Discussions and examples are for illustration only and do not imply the offering of any legal or financial advice by the author.

Historical Setting

Financing capital outlay was of little concern in the early years of our country. When schools were constructed by volunteers with no thought or consideration for such things as tax rates, bonds and bond referendums. The National Education Finance Project Study reported that one hundred years ago when legislatures began enacting laws to allow the issuance of bonds for public school districts, they were primarily concerned with three things: protection of the bond purchasers, limitation of the amounts spent on construction and limitation of the public debt. Through the early 1900s, the major responsibility of financing the public school building rested with the local community. As late as 1941, it was reported that only twelve states made some financial provision for capital outlay and debt service. These states had "crude and inequitable distribution systems in which the principles of equalization were neither recognized or applied. . . ." Some states did loan money to local districts with low interest rates.[2] After World War II, however, number of states that contributed to capital outlay and debt service increased dramatically.[3] Possible reasons for this increase include the fact that: few school buildings were built during the Depression, population growth,[4] a surplus of state revenues[5] and the growth of minimum state standards for facilities.[6]

Recent Trends

Since the 1960s, most school finance reform has involved state equalization

plans. While reformers have tended to concentrate on the basic foundational programs, little examination has been made of the area of capital outlay. Despite what are in many instances pressing needs, school districts with low property values have great difficulty financing educational facilities in many states. It has been suggested on several occasions that *Serrano* type litigation may occur with regard to the financing of capital outlay in certain states.

State aid for capital outlay and debt service grew from $78 million in 1951, to $633 million in 1970,[7] to an estimated $1.4 billion in 1979.[8] Yet, even after this tremendous expansion of state aid, it is estimated by the author that 80 percent of all funds for public school capital outlay and debt service will originate as local property tax. In perspective, the total capital outlay costs in 1979-80 amounted to approximately 7.5 percent of all funds expended for public elementary and secondary education in the United States.[9]

Bond Referendums

Local communities generally have strong input into the financing of school facilities. Well over 75 percent of all capital outlay costs are funded through bond sales which must be approved by a referendum. In general, the approval rate of such referendums has declined since the late 1950s. While the rate of passage has steadily declined, the number of offerings held for public approval has also declined. Offsetting this decline has been a steady and rapid climb of par values (amounts of principal) due to the escalating costs of construction, and the decline of purchasing power by school districts due to inflation.

Construction and Interest Costs

The number of classrooms constructed rose from 30,900 in 1949 to 75,000 in 1967[10] and then decreased dramatically. During this period, the average expenditure per classroom rose from $32,815 in 1949 to well over $60,000 in 1980. Inflation has been a major factor in the steadily increasing capital expenditures. The Cost of Commercial and Factory Building Index has increased from 100 in the base year 1972 to 201.8 in 1980, as estimated by the U.S. Department of Commerce. The Composite Construction Cost Index, which rose from 64.8 in 1963 to 2340.2 in December of 1980, represents a 255 percent decrease of purchasing power in seventeen years. The Composite Construction Cost Index rose nearly 40 percent from 163.7 in November of 1977 to 228.5 in November of 1980.[11]

During approximately this same period of time, interest rates increased from 3.11 percent in the early 1960s to a high of 10.56 percent in 1981 for all general obligation bonds. Consistently, general obligation bonds have shown the highest bond ratings and, conversely, the lowest interest rates. Non-rated bonds had the next highest interest rates, while revenue bonds had the highest overall interest rate reaching 11.41 percent in 1981. The net increase costs of bonds for school purposes sold by states have tended to be lower than those sold by minor government divisions (civil or school).[12] Over the past few years, not only has the cost of construction increased substantially, but also the cost of obtaining the money.

Population Projections

In many communities there is a backlog of needed classroom construction. This backlog constitutes the need of adequate housing for new and replacement class-

rooms for school children throughout the country. This backlog has continued to grow and add to the facilities needed to house new programs such as early childhood education. Special education will constitute the need for new and replacement facilities throughout the 1980s.

Since it is projected that the school age population will decrease, or at least remain stable during the 1980s, it may be assumed simplistically that public school districts will need fewer classrooms and thus need to build less in each succeeding year of the 1980s. The public is beginning to examine more critically the issuance of new debt because of rising construction costs dramatically juxtaposed with declining enrollments. On closer examination, however, local taxpayers may be called on to assume a greater tax burden for any of the following reasons:

- Population shifts within districts.
- Enrollment pattern among grade levels.
- Buildings that do not comply with safety and health standards.
- New educational programs.
- Changes necessary because of energy consumption.[13]

Additionally, on a state and regional level there are substantial variations in student population projections between states ranging from large increases to large decreases depending on migration patterns, economic conditions of the area and fertility rates. Some areas will need more classrooms while others will have a surplus.

Bonds

The vast majority of all moneys for capital outlay are raised through general obligation municipal bonds. School districts issue a bond where the payment is guaranteed by the full faith and credit of the issuer. A school district bond is a debt obligation of the school district. The general rule is that higher quality bonds pay lower yields (interest) to the investors. Generally, the bonds are payable by the ad valorem (property) taxes and in some cases other general revenues. A municipal bond is any bond issued by a state or local governmental unit including a school district. Since many variations exist due to state statutes, some fiscally dependent school systems issue bonds in the name of the county commissioners, city or town. There are numerous bonds that may be issued by governmental agencies ranging from lease-rental bonds to industrial aid revenue bonds. Brief mention is made of revenue bonds and holding corporations but this is mostly for informational purposes as few states permit school districts to engage in such activities.

Municipal bonds receive federal tax exempt status on their interest earnings. They are not exempt from federal inheritance taxes. Most states and localities also exempt municipal bond interest payments from taxes. Municipal bonds may be subject to state taxes in some states while other states exempt them only in the state of issuance. Such federal tax benefits are very attractive for many individuals. For example, an examination of the Economic Recovery Act of 1981 for federal taxes scheduled for 1984, reflects that a joint return with a taxable income of $50,000 would be in the 40 percent tax rate bracket. If that couple were to invest in school district bonds returning a net interest rate of 9.5 percent, the yield on this tax exempt security would be 15.83 percent. One can readily see the attractiveness of

such investments. The security of most highly rated municipal bonds has been expressed by the New York Stock Exchange:

> They are considered second only to obligations to the Federal Government. During their severest test—The Great Depression—only about 1/5 of 1 percent suffered any loss of principal and less than 2 percent defaulted, that is, failed to pay interest or principal on time. In most of these cases, bondholders eventually received their interest and principal.[14]

Nearly all school bonds are serial bonds due to state statutes as a result of the mismanagement of term bonds during the early 1900s. Serial bonds are numbered and are payable, in accordance with state statute, semi-annually or annually during the life of the issue. The lower numbered bonds are retired first, paying greater shares of interest during the first stages of the issue. As the interest is payed, greater portions of the principal are paid. A sample amortization schedule is included in this chapter illustrating this concept.

In a few rare instances, some states permit the issuance of term bonds. A term bond permits payment on the interest only with the principal repayment due at the end of the issue. Again, adequate bond counsel is necessary to answer specific questions concerning the permissibility of term issues.

Sinking Funds

Allowed in a few states, sinking funds permit the school district to levy a specific tax, invest the funds over a period of time and use them for the construction of an educational facility. Critics of this process cite the erosion of the savings through inflation, numerous instances of mismanagement, poor investment practices and changed facility priorities over the life of the tax. Proponents cite the savings of the interest rates as well as the ease of not facing a referendum. Again, it must be stressed that the use of these cumulative building funds is limited to a few states.

Current Revenues

Financing capital outlay from current revenues is often suggested by those who cite the interest savings and ease of administration in their proposals. The use of moneys for capital outlay projects does not provide for leverage within the budget. Assuming maximization of the school budget, most moneys should be allocated to the direct learning activities of the schools. It is rare that the private sector finances its own internal growth from earnings. In like manner, school districts must issue bonds due to:

- Lack of cash flow or resources to tax.
- The attempt to maintain the tax rates on a reasonably consistent basis.
- The principle of inter-generation states that the school facility will be used by several generations of residents, and, therefore, it is improper for one generation to assume the entire burden.

- If we make the assumption that there will be some inflation within our society, the value of today's money will be less in the future in purchasing power; hence, simple rate of return on investment schedules may be determined reflecting that, over time, the building is being paid off with "cheaper" moneys.

Holding Corporations

In a few states, school districts are allowed to form holding corporations which, in actuality, are lease-rental arrangements for the construction and purchase of educational facilities. Essentially, states allow school districts to enter into lease-rental agreements with a public or private corporation in accordance with specific statutes. Such agreements usually specify that the school becomes the property of the school district when it is paid for in full. In the few states where such arrangements are allowed, the indebtedness under these arrangements is not considered against the constitutional or statutory limitations of bonded indebtedness. Generally, these holding corporations consist of a group of local citizens who form a corporation for the sole purpose of building a new facility. The holding corporation acquires the revenue under the auspices of the school district (usually treated as a revenue bond), builds the facility and leases it to the school district as a non-profit activity. Again it must be stressed that the employment of legal and financial counsel is absolutely essential, as such activities are limited to a few states.

Bond Ratings

The investment community which requires some form of uniform standard by which to judge the attractiveness of investments, has established a ratings system. Bond rating agencies are extremely important in protecting the investor's money as well as for the overall organization and comparability of issues. General obligation issues of any substantial size are rated generally by a private agency. The primary national bond ratings agencies are Moody's Investors, Standard and Poor's and Fitch Investors. Higher ratings represent better issues. It is important to note that the listing does not make the issue, but rather the issue makes the rating. With very few exceptions, the higher the rating, the lower the interest rate. Since lower ratings reflect greater risk, school districts are willing to pay higher interest rates to those who take the risk.

It is important to note that not all school districts' bonds are rated. For example, if the issue is to be sold to local investors, i.e., a local bank, rather than being rated, the bank officials may request certain financial information directly from the school district. Additionally, below certain dollar amounts, the rating agencies do not issue ratings (e.g., Moody's does not issue ratings for general obligation bonds below $1.5 million).

While each agency is different with respect to rating structure, the ratings are based on the soundness of investment to the lender. The following are explanations provided by Moody for its municipal bond rating system:

Aaa

Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edge." Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most to likely to impair the fundamentally strong position of such issues.

Aa

Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.

A

Bonds which are rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future.

Baa

Bonds which are rated Baa are considered as medium grade obligation; i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and, in fact, have speculative characteristics as well.

Ba

Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

B

Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

Caa

Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

Ca

Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C

Bonds which are rated C are the lowest rated class of bonds, and issues so rated can be regarded as having poor prospects of ever attaining any real investment standing.

Con . . .

Bonds for which the security depends upon the completion of some act or the fulfillment of some condition are rated conditionally. These are bonds secured by a) earnings of projects under construction, b) earnings of projects unseasoned in operating experience, c) rentals which begin when facilities are completed, or d) payments to which some other limited condition attaches. Parenthetical rating denotes probable credit stature upon completion of construction or elimination of basis of condition.

Those bonds in the A and Baa groups which Moody's believes possess the strongest investment attributes are designated by the symbols of A 1 and Baa 1.

Standard and Poor's system of ratings have different symbols which reflect the soundness of investments. Briefly, Standard and Poor's system ratings are as follows:

AAA	Prime
AA	High Grade
A	Upper Medium Grade
BBB	Medium Grade
BB	Lower Medium Grade
B	Some Degree of Speculation
CCC	Greater Degree of Speculation
CC	Greatest Degree of Speculation
C,DDD,DD	Various Degrees of Default

Each rating agency charges a fee for rating an issue. Charges vary from a few hundred dollars for a small and simple issue to a high of $15,000 for large and complex issues. The rating for a particular issue is normally in effect until the issue is retired. Each firm releases the rating to the *Daily Bond Buyer*, in order for the issue to be examined by the investment community. Additionally, each firm publishes this information and makes it available to the investment community.

It should also be noted that not all issues are rated. Generally, small issues ($1.5 million) are not rated. Many issues are sold, pursuant to state statutes, in public sales without a rating. Small school districts issuing notes for rather small amounts often find it advantageous to sell the notes directly to a local bank. Usually the bank will resell the issue to local investors.

Legal Services

Every school district must employ competent legal counsel in issuing a bond. The school business administrator must, without exception, consult closely with a

law firm that has extensive experience with the issuance of public bonds. The bond attorney functions as the legal adviser to the board of education and ultimately to the investor. The attorney is concerned with the mechanics of the issue as well as the overall thrust of the issue in relationship to the legal thinking of the courts regarding the issue's appropriateness.

Most experienced bond firms maintain the necessary forms and documents normally in a computer. Fees vary from state to state based on the complexity of the state statutes and the time and costs incurred in examining all the necessary information. Bond counsels usually employ a quality school bond consultant to assist with the transaction. A small privately sold issue may result in very modest legal fees. A large, complex undertaking, such as a formation of a holding corporation for a special education cooperative involving many school districts, might result in fees of several hundred thousand dollars.

Moody's has offered the following advice regarding the selection of a legal adviser:

> The importance of competent legal guidance from the very start of your issue's preparation cannot be overemphasized. Once you decide on an improvement program, and choose to issue bonds instead of paying as you go, your first step should be the selection of an attorney skilled in handling municipal bonds. In general, the more experienced the attorney, the more money he will save you as a bond issuer and the less trouble you will have in bringing your bond issue to market.
>
> Your attorney drafts or approves the original bond resolutions and ordinances, the notice of the bond election, and the form of the ballot if an election is required under local law. Once voters have approved the issue, he reviews the preparation of a possible prospectus, financial advertisements, and the entire "package" presented to underwriters for bidding. After the bonds have been sold, printed, paid for and delivered, he renders a final legal opinion. Bond buyers today rarely accept delivery of bonds if such an opinion is not furnished.
>
> Perhaps your public unit's own counsel or another local attorney may be able to do as fine a job as a specialist, but it is better not to take the chance. Just a tiny technical error may require that you re-advertise the offering. Also, a bond accompanied by what underwriters call a "local" opinion generally sells at a lower rate (i.e., higher interest cost) than a bond of the same public unit which carries a "marketable opinion." A marketable opinion is simply an opinion by a legal specialist whom underwriters and investors recognize as of proven competence.
>
> Dealers want to know before they bid that a final legal opinion will be furnished with the bonds when delivered.
>
> If, for some reason, your community decides not to secure a legal opinion, it must allow the bidders to name their own attorneys. This, quite naturally, will be at the community's expense. Bidders will subtract it from the price they offer for the issue.[15]

Moody's offers a specific checklist for the issuance of municipal bonds that is applicable to school business administrators involved in a school bond issue. Some of the items on the checklists are:

- Retained an attorney with extensive experience in the laws of your state that affect municipal bonds.
- Retained an attorney who has a record of "marketable opinions"
- Turned over to the attorney all proceedings preliminary to those in which he, himself, participated.

Consulted the attorney in all phases of issue, including:

- election (if any) notices
- election (if any) procedures
- method of determining the best legally acceptable bid.

Financial Advisement

Increasingly over the last few years, governmental units have been turning to financial advisement individuals/firms for expertise in issuing bonds. School districts have often found that the independent financial adviser is an extremely cost effective means by which the overall efficiency of return is increased. School districts rarely retain on staff a person skilled in bond market analysis, preparing the prospectus, advanced refunding and reinvestment of proceeds. A financial adviser may be particularly helpful in answering the following questions for a school district:

Is the financial undertaking feasible?

Are the economic resources sufficient to support a marketable financial plan?

What are the various financial options?

What is the most marketable, least costly debt retirement program?

What are the most efficient issue sizes, maturity schedules, prepayment options and bidding provisions for the proposed project?

What covenants will protect the interests of the investor and the school district?

What is the optimum timing for the new issue?

What should be done to make an accurate presentation to the rating agency?

How can the school district create maximum demand for the issue?

How can investments of the proceeds maximize the use of temporarily idle funds?

What are the future needs, based on the economy and growth of the school district?[16]

The independent financial adviser oftentimes has the expertise to examine the school district's financial position and to represent the district in the bond market as well as to handle the reinvestment schedules for maximum efficiency to the district. These services are often necessary for the small school district that has rarely sold bonds and does not expect to sell additional bonds within the near future. The financial adviser should be willing to provide certain services such as:

- Consult with architects, engineers and bond attorneys in the preparation of financing plan, resolutions, ordinances and certificates.
- Assist in the timely publication of official documents.
- Coordinate the formation of an appropriate holding corporation/building authority (where legally permissible).
- Answer any questions, if necessary, of various governmental authorities or school community groups.
- Prepare and distribute the official prospectus to bidders in the major money markets.
- Prepare and present the appropriate materials for optimum credit ratings.
- Arrange and conduct informational meetings for the investment community.
- Conduct the sale.
- Coordinate the printing of bonds and closing documents for timely delivery to the purchaser.
- Analyze cash flow and manage the investments of bond proceeds.[17]

It is important to note that the financial adviser should tailor the services to fit the needs of the school district. For example the needs and desires of a small school district that may face the issuing of general obligation bonds once every thirty years are obviously different than that of a major urban school district that is constantly entering into long-term debt as well as retiring debt issues.

The worthiness of hiring an individual/firm to serve as the financial adviser in issuing general obligation bonds or entering into any form of debt cannot be looked upon lightly. The employment of such an individual/firm may prove to be quite cost effective for many smaller school districts.

The Prospectus

The prospectus, or official statement, is the document that communicates all the needed information about the school district to the financial community. It is, by

necessity, a complete description of the community, i.e., the school district and the factors that bear on the future economic outlook of the community.

An outline of a Prospectus follows each section of which it is important to note that the details will change according to each situation and the applicable state law. Under no circumstances should a school business administrator view these examples as being applicable to his or her situation. Nor, is it to be interpreted as legal or financial advice.

Statement

The official statement is usually found in the beginning of the prospectus. Normally, it summarizes and highlights the issue. An example of a twenty-year general obligation bond statement appears below:

OFFICIAL STATEMENT
(NEW ISSUE)

_____

SCHOOL BUILDING BONDS
SCHOOL DISTRICT OF _____

Bonds Dated _____ Principal Due _____

These Bonds are being issued pursuant to _____ for the purpose of paying for construction, erecting and equipping _____.

The Bonds will be general obligation of the District for which the full faith and credit and unlimited taxing powers are pledged.

The bonds are being issued in registered for, $ _____ denominations. Interest is payable _____, _____ and semiannually thereafter.

Bids must be for not less than _____ and accrued interest on the total principal amount of the issue. Bids must be accompanied by a certified or cashier's check in the amount of _____ payable to the order of the School District Treasurer.

The Bonds will mature _____ ____ in the amounts and years as follows:

1985 _____	1992 _____	1999 _____
1986 _____	1993 _____	2000 _____
1987 _____	1994 _____	2001 _____
1988 _____	1995 _____	2002 _____
1989 _____	1996 _____	2003 _____
1990 _____	1997 _____	2004 _____
1991 _____	1998 _____	

Bonds maturing in the years _____ are subject to redemption on _____, _____ and any interest payment date thereafter at par plus accrued interest.

The Bonds are offered subject to the legal opinion of

_____

In the opinion of Bond Counsel, interest on the Bonds is exempt from present Federal Income Taxes.

Bid Opening & Award Time _____

Rating: An application has been made to Moody's Investors Service, Inc.

The Date of this Official Statement is _____

Purpose

The statement of purpose would normally follow the Official Statement. Depending on the complexity and various state legal requirements, it may be simple or extremely detailed. An example of a simple statement might be, "The bonds will be issued to finance the cost of improvements to school buildings." However, more complex circumstances and legal requirements may warrant a more detailed explanation, for example:

These Bonds are being issued pursuant to _____ for the purposes of building and equipping an elementary school complex and a swimming pool addition. The new school will replace the _____ Elementary School that was gutted by fire on _____. The School Board unanimously voted on _____ to accept an insurance settlement of _____. These funds, in addition to the proceeds of this issue, comprise the building program.

Students displaced from the burnt facility were housed in various rural structures, churches and the City's Armory. Additional cost to the District is _____ per month for rental of _____ structures.

On _____ the electors of the District authorized by a vote of _____ "yes" to _____ "no" to borrow an amount not to exceed _____ of its general obligation bonds for the purpose of building and equipping an elementary school complex; and by a vote of _____ "yes" to _____ "no" to borrow an amount not to exceed _____ of its general obligation bonds for the purpose of building and equipping a swimming pool addition to the elementary school complex.

The new school will be built on land already owned by the District. An architectural firm has been retained. At the present time, the School District intends to sell the old site and fire damaged building and use the proceeds to reduce outstanding indebtedness. Occupancy of the new school is anticipated to occur in the fall of _____.

Date, Type, Denomination and Maturities

The dates, types and denominations are shown in the following example. This example reflects a non-callable issue.

The Notes will be dated as of _____, will be issued as registered negotiable investment securities, will be in the denomination of _____ each unless designated otherwise by the purchase within 48 hours of award of sale, and will mature serially, without option of prior payment, on _____ in the following years and amounts:

	PAYMENT	PERIOD	PRINCIPAL	INTEREST	TOTAL
1.	12/2/84	12/1/85		$593,750.00	$593,750.00
2.	12/2/85	12/1/86	$115,000.00	$475,000.00	$590,000.00
3.	12/2/86	12/1/87	$125,000.00	$464,075.00	$589,000.00
4.	12/2/87	12/1/88	$140,000.00	$452,200.00	$592,200.00
5.	12/2/88	12/1/89	$150,000.00	$438,900.00	$588,000.00
6.	12/2/89	12/1/90	$165,000.00	$424,650.00	$589,650.00
7.	12/2/90	12/1/91	$180,000.00	$408,975.00	$588,975.00
8.	12/2/91	12/1/92	$200,000.00	$391,875.00	$591,875.00
9.	12/2/92	12/1/93	$215,000.00	$372,875.00	$587,875.00
10.	12/2/93	12/1/94	$240,000.00	$352,450.00	$592,450.00
11.	12/2/94	12/1/95	$260,000.00	$329,650.00	$589,650.00
12.	12/2/95	12/1/96	$285,000.00	$304,950.00	$589,950.00
13.	12/2/96	12/1/97	$315,000.00	$277,875.00	$592,875.00
14.	12/2/97	12/1/98	$345,000.00	$247,950.00	$592,950.00
15.	12/2/98	12/1/99	$375,000.00	$215,175.00	$590,175.00
16.	12/2/99	12/1/00	$410,000.00	$179,550.00	$589,550.00
17.	12/2/00	12/1/01	$450,000.00	$140,600.00	$590,600.00
18.	12/2/01	12/1/02	$490,000.00	$ 97,850.00	$587,850.00
19.	12/2/02	12/1/03	$540,000.00	$ 51,300.00	$591,300.00
TOTAL			$5,000,000.	$6,219,650.	$11,219,650.

The previous data are for a twenty-year general obligation bond at 9.5 percent over the life of the issue. Note the delay of the payment of the principal. This example reflects an even payment period over the life of the issue. In many states this even payment schedule is required by statute.

Paying Agent

It is customary that the successful bidder be allowed to reasonably designate the depositor to which the future payments shall be made. The following statement reflects this practice and the conditions of specificity:

> Principal and interest will be made payable to any suitable bank designated by the successful bidder within 48 hours after award of sale, subject to approval by the School Board, and the District will pay the reasonable and customary paying agency charges. If the paying agent is not selected within 48 hours after the award of sale, or if it is not satisfactory to the District, the District will select the paying agent.

Interest Payment Dates and Rates

It is important to note that the prospectus clearly outlines the method of bidding the fractions and the maximum amount that the district will entertain in the cost of borrowing funds. In order to make the bidding on an even more competitive basis and the ease of ascertaining what the lowest bid is, it is common to see a specified range for the bids (e.g., 1.5 percent). It is customarily stated that the bonds be bid

on face value, i.e., for the full amount plus interest as opposed to a discount which is for less than the face amount, the difference is the discount reflecting the interest. A statement to that effect is as follows:

> Bidders are requested to name the interest rate or rates the bonds are to bear in multiples of one-twentieth of one percent, but not exceeding _____ percent per annum. The difference between the highest and the lowest rate bid shall not exceed _____ percent. There will be no limit on the number of rates of interest that may be specified. One rate of interest shall apply to all bonds of the same maturity. Interest payable on any bond on any interest payment date shall be represented by payment schedule, and no bid will be considered for less than par and accrued interest for all of the bonds.

Delivery

Delivery deadlines and language often vary; however, a time line, cost, if any, and other dates as necessary may be included. Three examples of a delivery statement follow:

> *Example 1.* The bonds are expected to be ready for delivery within 30 days after the sale. Delivery anywhere in the continental United States will be made at the expense of the school district. Payment for the bonds must be made in federal funds or other immediately available funds.
>
> *Example 2.* The district will furnish without cost to the purchaser and within 60 days after award of sale the printed and executed Notes, the legal opinion of _____, and the usual no-litigation certificate. Delivery will be made without cost to the purchaser at the place of the purchaser's choice. Payment for the Notes must be made in funds immediately available to the District on the date of delivery.
>
> *Example 3.* Within 40 days of the date of the sale, and without cost to the purchaser, the District will furnish and deliver at any point in the continental United States, the printed and executed certificates, and the opinion thereon of _____, to the effect that the certificates of indebtedness are valid and legally binding obligations of the District and, unless paid from other sources, are payable from ad valorem taxes levied upon all of the taxable property within the District without limitation as to rate or amount.

Legal Opinion

Legal opinions will vary dependent on the state and firm offering the opinion. If an unfavorable preliminary opinion were to be issued, the sale should be cancelled or delayed by the school business administrator until all legal qualifications have been fully met. Generally, the final legal opinion is not issued until after the sale. Again, the reader is cautioned that these examples are given to familiarize the potential school business administration student with legal opinions. Under no circumstances should these examples be considered as offering legal advice. Additionally, the reader should note that legal opinions will vary depending on the legal firm and the applicable state statutes.

> *EXAMPLE 1.* We have acted as Bond Counsel in connection with the issuance by School District of _____, State of _____, of its Certificates of Indebtedness, dated as of _____, in the aggregate principal amount of _____. The Certificates bear interest at the rate of

_____ percent (_____ %) per annum and are payable as to both principal and interest on _____, without option of prior payment. The Certificates bear serial numbers and are in denominations as follows:

Serial Numbers	Denominations, Each
###############	----------

Both Principal and interest are payable at _____, in _____, _____.

For the purpose of giving this opinion, we examined certified copies of certain proceedings taken by the School District in the Authorization, sale and issuance of the Certificates, including the form of the Certificates, and certain other proceedings and documents furnished by the School District. From our examination of such proceedings and other documents, assuming the genuineness of the signatures thereon, and the accuracy of the facts stated therein, and based upon laws, regulations, rulings and decisions in effect as of the date thereon, in our opinion:

1. The Certificates are in due form, have been executed and delivered and are valid and binding general obligations of the School District in accordance with their terms to which the full faith and receipts of the School District are pledged.

2. The Certificates are issued in anticipation of the receipt of taxes levied for its _____ fund for collection in _____, of which an amount equal to the principal and the interest on the Certificates has been irrevocably appropriated to a special debt service fund for the payment of such principal and interest. All of the taxable property within the School District is subject to the levy of additional taxes if needed for the payment of the Certificates, without limitation as to rate or amount.

3. The Certificates are exempt from taxation as property by the State of _____ and its subdivisions and municipalities and the interest to be paid on the Certificates is not included in gross income of the recipient for United States or State of _____ income tax purposes, except _____ corporate franchise taxes measured by net income.

Dated at _____, _____, _____, _____

EXAMPLE 2. The bonds are dated _____, _____, _____; are of $_____ denomination; are numbered 1 to _____, inclusive; mature serially on _____ of each of the years and in the amounts as set forth below and bear interest payable _____ and semiannually thereafter on _____ and _____ of each year at the rates per annum as follows:

Year	Amount	Interest Rate
####	$$$$$$	%%%%%%%%%%%

Bonds maturing on and after _____, _____ are subject to redemption prior to maturity as a whole, or in part in inverse order of maturity and within each maturity by lot, on _____, _____ and on any interest payment date thereafter at the principal amount thereof and accrued interest to the date of redemption.

We have examined the documents which we deem pertinent to the validity of said bonds, including the certified record evidencing the authorization of said bonds by the City Council of said city. On the basis of such examination, we are of the opinion that said bonds have been lawfully authorized and issued under the laws of the State of _____; that they are the lawful and enforceable obligations of said city in accordance with their terms; that they are payable from taxes to be levied on all taxable property in said city, without limitation as to rate or amount; and that executed bond number one of said issue, which we have examined, is in proper form.

It is our opinion, based on existing laws, regulations, decisions and interpretations, that interest on said bonds is exempt from present Federal Income Taxes.

Types of Bid and Award

Certain states have a prescribed manner in which bids must be let. A few states specify that all bids must reflect one interest rate for the entire issue. Generally, the bidder may specify any combination of rates. The comparison of multiple rates is relatively simple. Good faith checks, based on statute and custom vary from state to state. A good faith check generally is required for 1 to 5 percent of the par value of the issue and is included in the bid documents. The following reflects a multi-interest rate bid, the method of calculation and the manner of award.

Sealed bids may be mailed or delivered to the undersigned and must be received prior to the time of said meeting. Each bid must be unconditional except as to legality, which may be conditioned upon the legal opinion specified previously, and must be accompanied by a cashier's or certified check or bank draft in the amount of _____ payable to the School District Treasurer, to be retained by the School District as liquidated damages if the bid is accepted and the bidder fails to comply therewith. The bid authorizing the lowest net interest cost (total interest from date of certificates to maturity less any cash premium) will be deemed the most favorable. No oral bid, and no bid of less than par will be considered, and the School Board reserves the right to reject any and all bids and to waive any informality in any bids.

Since the purpose of the prospectus is to attract the highest possible bond rating and thus the lowest interest rate for the school district, full and honest disclosure of all pertinent financial information is absolutely necessary. Failure to provide full and complete disclosure may drive up the interest rate or preclude any bids. The following data are representative of the types of information normally found in a prospectus:

VALUATIONS	1985/86 Equalized	1985/86 Assessed
"A" County	$150,092,698	$66,838,503
"B" County	29,321,180	4,754,233

Prior Years:	
1983/84	$154,815,000
1982/83	131,405,800
1981/82	116,830,900
1980/81	99,564,700

ANALYSIS OF CURRENT EQUALIZED VALUATION
OF A SCHOOL DISTRICT

1985 EQUALIZED In School District		% OF District Valuation
City of "A"	$43,960,960	24.50%
Township of "B"	58,628,070	32.68%
Township of "C"	14,873,790	8.29%
Township of "D"	11,766,652	6.56%
Township of "E"	1,627,396	.91%
Township of "F"	6,168,500	3.44%
Township of "G"	6,561,750	3.66%
Township of "H"	6,505,580	3.62%
Township of "I"	5,550,700	3.09%
Township of "J"	23,770,480	13.25%
	179,413,878	100.00%

General Obligation Direct Debt—As of January 1, 198-

Purpose	Dated	Rates	Maturities	Principal Amount Outstanding
School Building Bonds	4-1-67	3.25%	4-1982/87	$165,000

Various states have limitations on the amount of debt that may be incurred by school districts within those states. This limitation varies among the states and must be carefully ascertained. Generally, the total outstanding principal of all the general obligations bonds is limited to a percentage of the assessed valuation. The prospectus should reflect such a condition, for example:

DEBT LIMITATIONS

Pursuant to _____ Constitution and Statutes, the District of _____ is subject to a debt limitation of _____ percent of the value of taxable property located herein as assessed for state purposes.

Legal Debt Limit for District (_____% of Assessed Value)	$$$$$$$$$$
Debt Outstanding as of _____	$$$$$$$$$$
Current Debt Capacity	$$$$$$$$$$

It is also important to realize that bond ratings reflect total outstanding debt from all forms of governmental indebtedness. That is, the taxpayers who reside within the district are also subject to additional taxes. Despite the fact that a given school district may have little, if any, debt, the outstanding debt of other governmental units may reflect adversely on the school district. In those states where school systems are part of and co-mingled with county/city forms of government, the problem of overlapping debt is not reflected. The debt of the school district is reflected within the overall governmental structure. A brief example of an overlapping debt schedule is reflected as an example of this display:

OVERLAPPING DEBT

Valuation in District Net General Obligations

	Total 85/86 Assessed Value	Amount
"A" County	$4,588,800,295	$472,295,567
"B" County	163,280,902	1,292,263
City of "C"	475,172,286	472,295,567
City of "D"	20,947,237	1,292,263
I.S.D. No. 1	2,854,868,356	473,577,830
Metro Council	8,174,627,264	473,577,838
Metro Transit	7,580,857,145	473,587,838
Metro Airport	8,174,627,264	473,587,838

	%	Debt	Net G.O. Debt to District
"A" County	10.29%	$41,450,000	$ 4,265,205
"B" County	.79%	780,000	6,162
City of "C"	99.39%	29,454,984(1)	29,275,309
City of "D"	6.16%	6,020,000	370,832
I.S.D. No. 1	16.58%	16,300,000	2,702,540
Metro Council	5.79%	36,300,000(2)	2,101,770
Metro Transit	6.24%	9,850,000	614,640
Metro Airport	5.79%	-0-	-0-
			$39,336,458

1) Excludes $4,015,000 Utility bonds and $525,000 State-Aid Street Bonds which are G.O. backed but supported primarily by systems revenues and state aids, and $1,080,000 recreational Facility Bonds payable from gross revenues. Also less $16,000,000 sinking funds and $5,500,000 utility revenue supported portion.

2) Excludes general obligation where bonds of the Metropolitan Council refunded January 1, 1979, and supported by an escrow fund established from refunding bond proceeds. Also excludes $945,000 Tax Anticipation Certificates due January 1, 1986. Excludes 487,000,000 of sewer bonds issued by the Metropolitan Council and metropolitan sewer system, which debt has been assumed by the Metropolitan Council. These bonds are supported from sewer service charges to the governmental units within the metropolitan sewer system. Includes Metropolitan Council bonds for parks and open space.

3) Excludes $175,000,000 current debt service of the Metropolitan Airports Commission, which is required to be fully supported by revenues from charges for the use of airports by airlines and others. Any tax levies for deficiencies must be reimbursed from increase charges.

The taxes per $1,000 of assessed value is usually found within the prospectus for the past several years. In many states the taxes are reflected on the basis of dollars and cents per $100 of assessed valuation. An abbreviated example of an assessed valuation table with the necessary explanatory statements are shown:

TAXES PER $1,000 OF ASSESSED VALUE (1)

	1985/86	1984/85	1983/84	1982/83
Special Sch Dist. No. 1.	$49.529	$49.426	$50.220	$50.463
City of "A"	43.421	48.564	48.571	43.711
Misc. (2)	3.493	3.052	4.416	3.508
" B " County	29.352	29.050	27.787	26.436
	$125.795	$130.029	$129.994	$124.118

1) Before property tax relief credit on homestead property at 45% of taxes (except County and City debt service taxes) to a maximum of $325.
2) Miscellaneous levies include those for the metropolitan Council, Metropolitan Transit Commission, Housing and Redevelopment Authority, Mosquito Control Board, Park Museum, and Watershed District No. 1.

In many states the mill rate is computed on the basis of several funds that make up the total school district tax. In those states that employ the use of multiple levies, a detailed sub-fund mill tax rate is shown such as the following example:

DETAIL OF 1985/86 SCHOOL DISTRICT MILL RATE

General Educational Program	31.002
Maintenance	3.808
Transportation	1.444
Additional School Services	1.772
Community Service	.570
Municipal Employees Retirement	2.596
Capital Outlay	3.398
Unemployment Compensation	.342
Debt Service	6.909
Statutory Operating Debt	1.690
	53.531

Normally, a brief explanation of the method of school tax collection is included in the prospectus. The following is an example:

The tax year in _____ is January 1 to December 31 and taxes are collected by the county treasurer. The sequence of events in the taxation of property begins with the certification of the property tax budget levy to the county auditor in the fall. The county auditor then calculates the mill rates and spreads the taxes designed to meet these budget requirements. The resulting taxes on property are payable the following year. The due dates for payment of taxes on real property are: one-half on or before May 31 and the remaining one-half on or before October 31. The due dates for payment of personal property taxes are: one-half on or before February 28 and one-half on or before June 1. On June 1 a penalty of 3% is charged against all unpaid taxes on property that has been accorded the homestead classification, and a penalty is charged on the first day of each month up to and including November 1 for both homestead and non-homestead property. On the first Monday in January following the year in which taxes are due, the penalty increase to a maximum of 10% on homestead and 14% on non-homestead property. Interest commences the second Monday in May following the year in which the taxes became due at the rate of 6% per annum. Personal property taxes are penalized at a rate of 8%.

Often the prospectus reflects the total tax levy that is not the amount of moneys that the school district actually receives. In these instances a tax collection table is necessary. The following illustrates an example of a tax collection table.

TAX COLLECTIONS

Tax Yr.	Tax Yr.	1st. Yr. Coll. Amount	%	Coll. to 1/1/86 Amount	%
1985/86	$4,029,000	In Progress			
1984/85	4,999,760			$4,986,343	99.73%
1983/84	5,012,239	$5,002,861	99.81%	5,004,054	99.83%
1982/83	4,380,449	4,367,814	99.71%	4,371,666	99.79%
1981/82	3,830,449	3,816,640	99.64%	3,822,400	99.79%
1980/81	3,530,904	3,521,143	99.74%	3,524,958	99.83%
1979/80	3,481,859	3,473,743	99.77%	3,477,219	99.87%
1978/79	2,452,036	2,420,466	98.71%	2,437,452	99.41%

In order to satisfy the requirements of full disclosure, the prospectus reflects an overall budgetary picture. Each state has different reporting and accounting requirements. Regardless of the state requirements, the prospectus must reflect generally accepted accounting practices. Usually, it is necessary for the school district to meet the requirements set forth by the Governmental, Accounting and Financial Reporting (GAFR) Audits of State and Local Governmental Units Standards. Further discussion of these points are contained in Chapter 5, "Educational Accounting Procedures," by S.B. Tidwell. The reader may also wish to consult Tidwell's *Financial and Managerial Accounting for Elementary and Secondary School Systems*,[18] for the definitive text in this area of school finance.

It should be stressed that the school business administrator must employ a qualified accounting firm to examine, audit and provide a financial overview acceptable to the investment community. The school district must meet all the rules and regulations of the GAFR and all applicable accounting procedures above and beyond what the state or local requirements may be. The following is an example of notes to financial statements pertaining to accounting procedures.

SCHOOL DISTRICT "A"
NOTES TO STATEMENTS OF RECEIPTS AND DISBURSEMENTS
Year Ended June 30, 1986

Note 1. *Summary Of Significant Accounting Policies*

a) Accounting Method: the accounts of the school district are maintained, and the accompanying statements have been prepared on the cash basis of accounting in conformity with accounting practices prescribed by the _____ Department of Public Instruction. Accordingly, income and expenses are recognized only as cash as received or disbursed and receivable, inventories, prepaid expenses, accrued expenses and vouchers payable are not reflected in the financial statements. Purchases of property and equipment are recorded as disbursements of various funds when paid. Checks for

teachers' salaries and related benefits for July and August are written prior to June 30, and are therefore reflected in the bank balance.

b) Uncollected Local Property taxes: At June 20, 1985, uncollected local property taxes aggregating $ _____ were due the School District for the year then ended. This represents an increase of $ _____ over the amount receivable one year earlier. These property taxes receivable have not been reflected in the accompanying statements.

Note 2. *Cash And Investments*

The debt service fund, building fund and pupil activity fund each account for transactions through a separate and distinct bank account or investment fund. Transaction of the other funds are all accounted for through a common bank account or investment fund. June 30, 1985 cash and investment balance requirements of funds that have common bank accounts and investments and as follows:

General Fund	$$$$,$$$.$$
Special Project Fund	$$$$,$$$.$$
Total	$$$$,$$$.$$

The common cash and investments of the District at June 30, 1985 were as follows:

"A" State Bank*		
Checking Account "#1"	$	($$$,$$$.$$)
Investments	$	$$$,$$$.$$
	$	$$$,$$$.$$

Note 3. *General Fund Advances Due From Other Funds*

As of June 30, 1985, the following fund is obligated to the general fund for previous cash advances:

Community Service Fund $ $$$.$$

Note 4. *Long-Term Debt (See Long Term Debt Section of the Official Statement.*

Note 5. *Employee Retirement Plan*

The School District substantially provides all of its contracted teachers and other professional staff with a retirement plan funded through contributions to the _____ Retirement System. The retirement plan requires an employee contribution equal to —% of the teaching salary plus an annually determined employer contribution rate (set at —% for the year ended 6-30-85). The total required contributions to the retirement system for the year ended June 30, 1985, were as follows:

School District's Share $ $$$,$$$.$$

The annual employer's contribution rate, which is actualized by the State of _____, provides for funding of prior service costs, including interest, over a period of — years. Information concerning the amount, if any, of the

excess of the actuated computed value of vested benefits over the total available in the pension fund is not maintained on a district by district basis.

Cash and Investments

A detailed account or an aggregated statement should reflect the cash and investments on hand. While often reflected in the prospectus as "Cash on Hand," the reality of sound school business management practices dictates that all "Cash on Hand" is in various investments as discussed in the chapter on cash management and banking. An example of an aggregated statement follows:

Cash and Investments—For all funds of the District
as of June 30, 1985 were $ _____

A detailed finite statement is illustrated:

CASH AND INVESTMENTS — June 30, 1985

General Fund	$$,$$$,$$$
Board of Education	$$$,$$$
Federal Revenue Sharing	$$$,$$$
Library	$$$
City-County Health	$,$$$
Sinking Fund	$$$,$$$
Central Equipment & Stores	$$$
Combined Capital Improvements	$$$
Miscellaneous	$$$
	$,$$$,$$$

Future Financing

The investment community is obviously interested in ascertaining if additional bonds are anticipated within the near future by the district or through an overlapping debt structure. Such a statement might read:

FUTURE FINANCING

None of the municipalities within the District anticipate the issuance of bonds/notes within the next six months for capital improvements.

Pending Litigation

The prospectus normally specifies whether there is any pending legal action which may have an effect on the sale, issuance or ability of the district to repay the obligation. It is important that bond counsel draft this section. A statement written by bond counsel is illustrated:

There is no controversy or litigation of any nature now pending or threatened restraining or enjoining the issuance, sale, execution or delivery of the bonds, or in any way contesting or affecting the validity of the bonds. There are no suits for damages currently pending against the District that are significant or that are not fully covered by liability insurance. Neither the District nor its attorney anticipate any litigation that would contain a significant de-

mand for financial relief against the District or its properties that would not be fully covered by liability insurance.

A somewhat simpler statement bond counsel might draft in some states is illustrated:

> There is no litigation now pending or, to the knowledge of District officials, threatened that questions the validity of the Bonds or of any proceedings of the District taken with respect to the issuance or sale thereof.

In the event there is anticipated or pending litigation, bond counsel must reflect the nature of the circumstances surrounding the possibility. It must again be stressed to the student of school business management that such statements be drafted by legal counsel.

Certification Statement

Often a certification statement is expected by the investment community. The certification statement is an assurance by the school district that all the information contained in the prospectus is accurate. An example of a certification statement commonly found in a prospectus follows:

CERTIFICATION

> The District will furnish, upon request, a statement to the effect that the Official Statement to the best of their knowledge and belief, as of the date of sale and the date of delivery of the bonds, is true and correct in all material respects, and does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading.

General Information

General information is included of an economic and demographic nature. The smaller the district the more acute the need for this type of information. There are few absolutes in what must be included or how it is organized and displayed. Often pictures are included of the present educational facilities, major industrial employers, banks and so on. Underscoring the need for this type of data, Moody's Investors Services explains:

> There is a large, comprehensive body of data available to an analyst on economic resources industry and employment, and population characteristics for the states, the counties, the cities of over 10,000 population. More limited data are available for places as small as 2,500 population. For districts that cut across boundaries, these standard data are lacking, and these kinds of districts include the most numerous single class of borrowers—school districts.[9]

General information for a relatively small community should be as thorough and complete as reasonably possible. This section would normally include such things as:

- Geographic and demographic information.
- Number, type, age, capacity and enrollments of the present educational facilities, etc.

- Prior enrollment patterns by grades.
- Number and classifications of personnel.
- Private school enrollments and status.
- University, college and technical schools within the community.
- Agricultural information (if the community is agricultural), including such items as size, cropland values, market value of agricultural products sold, and data available from the U.S. Census of Agriculture.
- Information on the form of city government and municipal services.
- The unemployment rate available from the state.
- Amount and value of building permits for the past few years.
- A listing of the largest property taxpayers within the district.
- An overview of the financial institutions of the district.

Sale of Issue

The actual sale of the issue is usually held at a time and place printed in the official prospectus. It is strongly suggested that the opening of the bid not take place at the same time as the awarding of the bid. The actual award should be held at a later date. The following outline is offered:

a) Schedule the actual bid opening for the day of a board meeting. At the time of the actual opening have all parties present to witness the opening and reading of the sealed bids.

b) Analysis of the bids would then occur over the next several hours (days). If multiple interest rates are received, they must be examined carefully.

c) The final awarding of the bids would then occur at the board meeting pursuant to the appropriate statutory guidelines and based on the analysis and advice of financial counsel.

The bids must always be sealed, delivered in an appropriate manner and received before the scheduled opening. The good faith check of the winning bid is deposited to the school district accounts. The uncashed good faith checks of the other bidders are normally returned via registered mail. It is customary for the winning bidder to be informed immediately by telephone and by certified mail.

In determining the best bid, a determination of the lowest cost to the district will be the lowest bid. In a single rate bid, the lowest rate determines the best bid, i.e., the total cost minus all premiums. In a split rate bid, the financial adviser or school business administrator must determine the net dollar cost to the district, i.e., the total cost minus all premiums. If the total cost is the same for the bids, the higher premium will determine the lowest net cost. It is important to remember that the total net cost must be determined by subtracting any premium charge.

Bond Registration

Presently, all bonds must be registered. Generally, municipal bonds are exempt from federal and state taxes but they are not exempt from estate taxes. The previous

system of bearer bonds was disallowed under federal law effective July 1, 1983, when the federal government mandated the registered format.[20]

Investment of the Proceeds

Most school districts when undertaking sizeable capital outlay projects have various amounts of excess moneys for different periods of time. These surplus funds must be invested pursuant to state statutes to maximize the return of the project. The investment of the cash flow, or more properly stated the reinvestment of the issue, can be a complex task.

The amount of the full issue will ultimately be spent by the school district. Although the total amount may be obligated to the project, portions are only payable on certain dates over the life of the project.

Great care and diligence should be exercised with the architectural/construction management team to set forth a viable construction payment schedule. With a construction payment schedule, the school district can then set forth an aggressive investment schedule for higher rates. The use of such moneys may be dictated by statute in some states, and the statutes must be examined closely by legal and financial counsel. The reinvestment schedule must be fully examined by legal counsel in order to meet all applicable Internal Revenue Service rules so they may not be considered arbitrage bonds.

Advanced Refunding

Where permissible, school districts may engage in advanced refunding to lower the total cost to the taxpayers. Advanced refunding is the issuance of a new bond issue to pay off the old bond one. If interest rates have declined, the new issue is less expensive and, therefore, sold at the lower rates.

It is important to note that the bond markets can fluctuate for several reasons. Generally, advance refunding is used when the outstanding bond has not reached the first call date or is not callable under the conditions of the sale. The proceeds of the new issue are invested in the highest return investments (all fully insured) with the maturities due before the payment schedule due date. The investment is normally in an escrow account established exclusively for the purpose of establishing the purchase of refunding bonds for the purchase of U.S. Treasury Securities. The escrow account then pays the refunded bonds to the maturity or the call date. Normally, a 1 to 1.5 percent difference in interest rates is necessary for such activity to be cost effective.

Most states allow for such activity while regulating the procedures and terms of such sales. The refunding process is restricted as to the investment yield based on the Treasury Department's arbitrage rules. Generally, the new issue will have a lower net interest cost due to a lower bond market/higher reinvestment schedule. It is important to note that the old issue is fully secured by the new issue's escrow investments.

Final interpretation of the 1986 tax code revisions regarding arbitrage had not yet been completed when this chapter was written.

Bond Insurance

Insurance is available for municipalities that purchase coverage to all bidders as guaranteed obligations. The largest such insurer, the Municipal Bond Insurance Association (MBIA), and the Financial Guaranty Insurance Company (FGIC), offer municipalities an AAA rating from Standard and Poor's and Aaa from Moody's. MBIA coverage is available to new issues for those issues that qualify. MBIA is owned by five large insurance firms. The municipality may purchase the coverage as a part of its offering, or it can qualify its issue as rated so as to have the bidder pay for the coverage. In theory, the purchase of insurance is cost effective because the municipality pays less interest due to its higher rating as a result of the no risk element to investors.

Summary

The area of capital outlay and bonding for educational facilities is an extremely broad and complex topic. Careful planning must be undertaken to ensure the efficient use of the facilities and taxpayers' moneys. Financial and legal counsel must be secured at the outset of the planning.

The school business administrator is the person in most districts who represents the district and the board of education to the investment community. The school business administrator should be prepared to gather and display basic information on the school district. Moody's has offered the following checklist for issuing ratings:

PRIMARY DOCUMENTS

1. Official statement or prospectus.
2. Notice of sale.
3. Annual reports or audits for the last three years.
4. Most recent budget for operations.
5. Capital budget or planning document.
6. Copy of local charter or document which describes governmental structure.
7. Ten-year enrollment trend and projection, school plant description, including facilities and capacity.
8. Legal opinion.

SUPPORT DOCUMENTS (FOR INFORMATION NOT CONTAINED IN ANY OF THE AFOREMENTIONED DOCUMENTS)

- Assessed valuation for the last five years.
- Equalized ratios for the last five years.
- List of ten largest taxpayers, their assessed valuation and type of business.
- Current population and latest census estimates.
- Tax rates and levies for the last five years, current and total collections, tax rates of overlapping jurisdictions.

- Tax assessment and collection procedures, including due dates and penalty rates.
- Tax and levy limitations.
- Debt or interest rate limits.
- Statement of direct debt and debt of overlapping debt issuers, including allocable share.
- Principal and interest payments of outstanding debt, each year by year, bonds segregated by security.
- Future borrowing plans.
- Number of building permits over the last five years, plus the dollar amount.
- Number of governmental employees and whether unionized and contract status.
- Statement regarding status of employee pension funds, latest actuarial study, if available.
- Local and area unemployment rate.
- List of ten major employers, number of employees and type of business.
- Area of the issuer (in square miles) and percentage of land that is developed.[21]

Notes

1. Portions of this introduction has been adapted from M.D. Alexander and R.C. Wood, "The Financing of Educational Facilities," *Planning and Changing*, 14 (Winter, 1983), 201-213.

2. G.D. Webber, *State Equalization of Capital Outlays for Public School Buildings* (Los Angeles: University of Southern California Press, 1941), 5.

3. W.M. Barr and K.F. Jordan, "Financing Public Elementary and Secondary School Facilities," *Planning to Finance Education*, ed. R.L. Johns, K. Alexander and K.F. Jordan (Gainesville, FL: National Education Finance Project, 1971), 240-241.

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5. W.M. Barr, *Financing Public Elementary and Secondary School Facilities in the United States* (Bloomington, IN: Bureau of Surveys and Administrative Studies, 1970), 141.

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7. Barr, 143-144.

8. Estimate based on data appearing in *State Public School Finance Programs, 1978-79*, ed. E.O. Tron (Washington, D.C.: U.S. Office of Education, 1980).

9. Estimate based on data appearing in *Finances of Public School Systems in 1979-80* (Washington, D.C.: U.S. Bureau of Census, CF-80, No.10).

10. Barr, 241.

11. The Composite Construction Cost Index reflects the Cost of Building Index and the previously issued Cost of Materials Index.

12. Based on major general obligation issues appearing in the *Bond Directory* during 1981 for twenty year issues.

13. W.R. Wilkerson, *Problems and Issues of Fiscal Neutrality in Financing School Construction* (Washington, D.C.: Office of Health Education and Welfare, Bureau of Elementary and Secondary Education, 1973), 9.

14. *Understanding Bonds and Preferred Stocks* (New York: New York Stock Exchange, Inc. 1978).

15. *Pitfalls In Issuing Municipal Bonds* (New York: Moody's Investors Service, Inc.), 24.

16. Adapted from "Public Finance and Management," (Minneapolis: Evenson-Dodge, Inc.), 5.

17. Ibid, 7.

18. S.B. Tidwell, *Financial and Managaerial Accounting for Elementary and Secondary School Systems*, 3d ed., (Reston,VA:Association of School Business Officials, 1985).

19. *Pitfalls in Issuing Municipal Bonds*, 36.

20. For a complete discussion of the requirements of registration see, J.E. Petersen and M.P. Buckley, *A Guide to Registered Municipal Securities* (Chicago: Municipal Finance Officers Association, 1983).

21. *Moody's Bond Record, Special Edition* "School District Ratings," (Moody's Investors Service, October, 1984).